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No. 79-1138

In the Supreme Court of the United States

OCTOBER TERM, 1979

RALPH H. SCHULZ, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

WADE H. MCCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20530

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The sole question presented in this federal income tax case is whether petitioner constructively received a refund of an overpayment of state income taxes that was available to him in 1971, but which he chose not to reduce to his possession during that year.

1. The pertinent facts may be summarized as follows: Petitioner filed his federal income tax returns on a cash and calendar year basis. During 1970, he directed his employer to withhold $3,699.98 from his salary for Wisconsin income taxes. That amount was more than twice his actual state tax liability for that year. On his 1970 Wisconsin tax return, petitioner chose not to have the balance of the credit ($2,577.29) refunded to him, but rather to have the sum retained by the State and credited

to future state income tax liabilities. In 1971, petitioner's employer, at his direction, withheld no state income taxes. On his 1971 state income tax return, petitioner applied the credit to satisfy his state tax liability (Pet. App. 1-2).

On his 1970 federal income tax return, petitioner deducted the full amount of state income taxes withheld. For 1971, petitioner did not itemize deductions, but claimed the standard deduction permitted by Section 141 of the Internal Revenue Code of 1954 (26 U.S.C.). However, he did not include in his 1971 gross income the $2,577.29 overpayment of state income tax which he was entitled to recover in that year (Pet. App. 1-2).

On audit, the Commissioner of Internal Revenue included in petitioner's gross income for 1971 the overpayment of his 1970 state income taxes. Petitioner paid the additional taxes and brought this refund suit in the United States District Court for the Eastern District of Wisconsin. The district court held that the state tax overpayment was includable in petitioner's 1971 gross income (Pet. App. 1-5). The court of appeals affirmed (Pet. App. 6-7).

2. The decision below correctly held that petitioner's state tax overpayment was includable in his 1971 gross income for federal tax purposes. Cash basis taxpayers may generally deduct advance payments of state income taxes in the year the payments are made, even where a portion of the tax paid may thereafter become refundable. See *Estate of Cohen* v. *Commissioner*, Tax Ct. Mem. Dec. (P-H) para. 70,272 (1970); *Estate of Lowenstein* v. *Commissioner*, 12 T.C. 694 (1949), aff'd on other grounds, 183 F. 2d 172 (5th Cir. 1950); Rev. Rul. 71-190, 1971-1 Cum. Bull. 70. If, in a later year, the taxpayer receives a refund of a portion of the previously paid taxes,

he must then include the refund in income in the year received to the extent that the refund resulted in a tax benefit in the year deducted. Section 111 of 1954 Code. See, *e.g.*, *Bird* v. *United States*, 241 F. 2d 516 (1st Cir. 1957); *Ben Bimberg & Co.* v. *Helvering*, 126 F. 2d 412 (2d Cir.), cert. denied, 317 U.S. 641 (1942); *Universal Inc.* v. *Commissioner*, 109 F. 2d 616 (7th Cir. 1940).

Here, petitioner obtained such a tax benefit for 1970 with respect to the state income taxes withheld from his income. While these amounts were substantially in excess of his actual liability, and were refundable to him in the following year, petitioner chose not to reduce the refund of 1970 taxes to actual possession in 1971, but to have them applied to future state income tax liabilities. He is nevertheless required to include in gross income the amount of refund to which he was entitled in 1971 because it was freely available to him and therefore constructively received in that year. See Treasury Regulations on Income Tax, Sections 1.451-1(a) and 1.451-2 (26 C.F.R.). See *Ross* v. *Commissioner*, 169 F. 2d 483, 486 (1st Cir. 1948); *Adams* v. *Commissioner*, 20 B.T.A. 243, 245 (1930). See generally, 2 J. Mertens, *Law of Federal Income Taxation* §§ 10.08-10.17 (1974 Rev.).

Contrary to petitioner's argument (Pet. 9-13), the rule of constructive receipt is well settled. See *Douglas* v. *Willcuts*, 296 U.S. 1 (1935). That doctrine, as embodied in Treasury Regulations on Income Tax, Sections 1.451-1(a) and 1.451-2, has long been approved by the courts. As this Court observed in *Corliss* v. *Bowers*, 281 U.S. 376, 378 (1930), "[i]ncome that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not."

Contrary to petitioner's further objections (Pet. 13-16), the application of the doctrine of constructive receipt does not deny him due process. There is no constitutional right to be taxed under the cash receipts and disbursements method of accounting. See, *e.g.*, *Resnick* v. *Commissioner*, 555 F. 2d 634 (7th Cir. 1977).

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

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